TREASURY MANAGEMENT – QUARTER 1 SUMMARY FINANCIAL REPORT 2014/15

EXECUTIVE MEMBER: Councillor Gillian Troughton
LEAD OFFICER: Angela George, Interim Finance Manager (S151 officer)
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WHY HAS THIS REPORT COME TO THE EXECUTIVE?

To inform Executive of the Treasury Management activity to 30 June 2014 and provide a forecast estimated investment interest to year end. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members are updated on treasury management activities regularly. This report therefore ensures this Council is implementing best practice in accordance with the Code.

RECOMMENDATIONS:-

I. Executive are asked to note the contents of this detailed Treasury Management Quarter 1 report. The forecast figures presented in this report are also reflected in the Revenue Budget Monitoring Report presented elsewhere on this agenda.

1. INTRODUCTION

1.1 The Treasury Management budget is subject to a detailed monthly review and forms part of the Revenue Budget Monitoring report presented to Executive on a quarterly basis. This report further details the monitoring position at 30 June 2014 and provides an estimate of expected investment income to the year end.

2. ECONOMIC OUTLOOK

2.1 Until 2013, the economic recovery in the UK from 2008 had been the worst and the slowest recovery in recent history. However in the first quarter of 2014 growth has surpassed all previous expectations, with interest rate forecasts shifting significantly from previously indicating an early 2015 first increase, to a recently predicted Q4 2014 (Capita Asset Services have since moved forward their first increase in Bank rate to Q1 2015). The medium term increases in bank rate will be "limited and gradual" and it is anticipated that rates will not return to around 5% as before the financial crisis.

2.2 However there remains a downside risk for our economy, as in the UK we are currently very dependent on consumer spending and recovery in the housing market. This is likely to be limited as many consumers have maximised their borrowing and wage inflation is less than CPI inflation so disposable income is being eroded.

2.3 We continue to forecast anticipated future investment returns and speaking with our Treasury Advisors, Capita Asset Services to consider alternative options in an attempt to maximise investment returns given the current and expected conditions. The Council has a low-risk appetite and it should be noted that our main priority is the security of the principal investment ahead of yield (although the return is still a key consideration).

3. TREASURY MANAGEMENT EXPENDITURE BUDGET & FORECAST 2014/15

3.1 The treasury management budget was set by Council alongside other revenue budgets on 27th February 2014.

3.2 The treasury management expenditure budget of £392k (excluding SLA's) mainly consists of non-controllable costs. £379k of this relates to the annual interest repayments on the Authorities only remaining £5m loan. These repayments of interest are made bi-annually in August and February each year. At the current time, the advice is to leave this loan in its present form as the penalty for repaying early (currently estimated at £3m penalty plus the £5m loan) would be prohibitive. This is however, continually reviewed with our Treasury Consultants, Capita Asset Services, and more details are presented at Appendix B.

3.3 The expenditure budget of £392k against an income budget of £205k results in a net budget for the treasury management function of £187k.

3.4 The expenditure budget forecast is detailed in the table below:

Table 1 – Expenditure Budget (excluding SLA's)

Budget £	Spent to Date £	Forecast of expected payments to 31/03/15	Total Forecast position as at 31/03/15	Variance as at 31/03/15 £
391,991	0	389,356	389,356	(2.635)

4. TREASURY MANAGEMENT INCOME BUDGET & FORECAST 2014/15

4.1 The treasury management income budget for anticipated investment returns for 2014/15 (£201k) on our cash held deposits. When this income budget was approved in February 2014, the budget was set at £50k lower than the previous year at £153k, with the assumption that interest rates could potentially fall further than they were in 2013/14. Due to the retention of the monies received from a major ratepayer and revisions to the strategy (see paragraph 3.3) we now anticipate that this will result in increased balances and better returns for this financial year. Work to rebase the revenue budget is underway (see Revenue Quarter 1 report elsewhere on this agenda) and as part of this work the Treasury Management target investment income budget has been restated back to its original position of £201k (from £153k) through a budget virement.

4.2 The income budget forecast is detailed in the table below:

Table 2 – Investment Interest Income

Investment Interest Budget revised at Quarter 1 £	Interest received to Date £	Interest on current outstanding investments	Forecast of expected investments to 31/03/15	Total Forecast position as at 31/03/15	Variance as at 31/03/15 £
201,822	45,835	104,465	62,522	212,822	11,000

4.3 As shown in the above table, a prudent full year forecast for investment interest at 30 June 2014 is £212,822, resulting in a possible income of £11k in excess of the budget as shown in table 2 above. Members should note that the financial markets remain very uncertain and the anticipated receipt is the forecast outcome and is not guaranteed. Any fluctuation in the estimated interest rate for July –March 2015 will impact on the interest received in that period.

4.4 Actual interest earned at 30 June 2014 was £150,300 (as shown in Table 2: £45,835 received to date + £104,465 outstanding guaranteed interest) against an annual budget of £201,822, which would result in a maximum deficit of £51,522 in the unexpected event of no further investment returns being achieved.

4.5 Whilst we took a prudent view when setting the income target for interest within the budget, the Treasury Management Strategy 2014/15 (which was approved by Council in February 2014) was also reviewed in light of the significant upfront NNDR (National Non Domestic Rates) receipt that we were due to receive. Other changes were also made to the strategy to maximise the Council's potential to earn more interest in the current economic climate. These changes and their impact include:-

- Increasing the limits on the part nationalised banks to £10m allowing the Authority the ability to place an additional £5m in total at a higher rate than within a call account.
- The introduction of additional counterparties (through a minor adjustment to the minimum credit ratings that Council agreed acceptable resulting in Barclays & Santander being included in our counterparty list for 2014/15). Any potential increase in risk is mitigated by the restriction on the length of investment to a maximum of 100 days. The use of these two additional banks (investments of up to £5m each) allows the Council to secure healthier returns than the alternative of overnight in Money Market Funds.
- Placing additional longer term investments in the first 6 months of the financial year as we have increased cash flow*, this, coupled with the higher values of investments placed results in an improved rate over that period.

*Cash receipts are up due to :
i) the upfront receipt of NNDR from a major ratepayer ***and***
ii) a major ratepayer appeal and the change to the NNDR system means we are holding monies back to repay the ratepayer in the event of the appeal being successful

(historically, this money would have been passed straight to Central Government who would have held the funds pending repayment).

4.6 Attached at Appendix A shows the Councils investments as held at 30 June 2014 detailing each counterparty, principal invested, period of investment, maturity date and yield.

5. WHAT ARE THE LEGAL, FINANCIAL AND HUMAN RESOURCES IMPLICATIONS?

5.1 Investment income will continue to be monitored and reported to Members on a quarterly basis in the Revenue monitoring report, and explicitly in this report, also on a quarterly basis.

6. STATUTORY OFFICER COMMENTS

6.1 The Monitoring Officer's comments are: No further comment

6.2 The Section 151 Officer's comments are: Included within the report

6.3 EIA Comments: None

6.4 Policy Framework: Within the Treasury Management Strategy 2014/15 approved by Council in February 2014.

7. HOW WILL THE PROPOSALS BE PROJECT MANAGED AND HOW ARE THE RISKS GOING TO BE MANAGED?

7.1 It is imperative that all budgets are monitored monthly with exceptions reported through Corporate Leadership Team and Executive so that management action can be taken to ensure the effective use of resources as planned by the Council.

7.2 The Treasury Management function will continue to be monitored and reported to Members. The budget monitoring process continues to be refined to provide members and officers with the up-to-date financial information needed to make key decisions on resource allocations during the year to feed into the Council's budget process.

List of Appendices:

Appendix A – List of Investments as at 30 June 2014
Appendix B – Detail on cost of repaying Copeland's outstanding loan of £5m

APPENDIX A

TEMPORARY INVESTMENTS AT 30th JUNE 2014

	AMOUNT	PERIOD OF LOAN	VALUE DATE	MATURITY DATE	RATE	VARIABLE/ FIXED	BASE RATE
BARCLAYS	4,990,000	INSTANT CALL			0.25%	VAR	**
BLACKROCK MMF	483,000	INSTANT MMF			0.32%	VAR	
FEDERATED INVESTORS MMF	4,990,000	INSTANT MMF			0.36%	VAR	
IGNIS MMF	4,990,000	INSTANT MMF			0.39%	VAR	
INSIGHT MMF	4,990,000	INSTANT MMF			0.35%	VAR	
LGIM MMF	4,990,000	INSTANT MMF			0.34%	VAR	
GOLDMAN SACHS MMF	2,182,000	INSTANT MMF			0.30%	VAR	
LLOYDS GROUP	7,450,000	364 DAYS FIXED	21/05/2014	20/05/2015	0.95%	FIX	
LLOYDS GROUP	2,540,000	364 DAYS FIXED	01/04/2014	31/03/2015	0.95%	FIX	
RBS CALL	0	INSTANT CALL					
RBS	7,440,000	90 DAYS FIXED	10/06/2014	18/09/2014	0.60%	FIX	
RBS	2,540,000	90 DAYS NOTICE	30/06/2014	03/10/2014	0.60%	VAR	
SANTANDER	5,000,000	90 DAYS FIXED	25/04/2014	25/07/2014	0.45%	FIX	
TOTAL	**52,585,000**				0.39%		0.50%

SUMMARY

	BALANCE	LIMIT	AVAILABLE
BARCLAYS	4,990,000	5,000,000	10,000
BLACKROCK MMF	483,000	5,000,000	4,517,000
FEDERATED INVESTORS MMF	4,990,000	5,000,000	10,000
IGNIS MMF	4,990,000	5,000,000	10,000
INSIGHT MMF	4,990,000	5,000,000	10,000
LGIM	4,990,000	5,000,000	10,000
GOLDMAN SACHS MMF	2,182,000	5,000,000	2,818,000
DMADF	0	Unlimited	Unlimited
LLOYDS GROUP	9,990,000	10,000,000	10,000
RBS	9,980,000	10,000,000	20,000
SANTANDER	5,000,000	5,000,000	0
	52,585,000		**7,415,000**

APPENDIX B

Detail and cost of repaying Copeland's outstanding loan of £5m – as assessed at May 2014

The possible repayment of debt is something that we keep under constant review and will continue to do so.

The reason the loan is so expensive to repay is the premium due to the loan provider, who loaned to us at 7.55% and would receive a much lower rate of interest if they allowed us to repay and then tried to re-lend the monies.

The repayment premium has been calculated by Capita (our Treasury Management Advisors) using the Public Work Loans Board (PWLB) discount rate as a proxy for the interest charged – currently at 3.33% - in simple terms this is the difference between the rate we borrowed at, being 7.55% and the rate we would borrow from the PWLB today, for a similar 28 year loan.

So £5m loan x (7.55%-3.33%) = £211kpa x 27.8 years remaining = £5.86m premium, discounted back to £3.807m – the actual premium calculated by the lender may differ slightly but this is not expected to be material.

As interest rates increase (and they are expected to as economy recovers) then the premium will fall and delaying repayment gives us less cost or conversely repaying now will cost us more. In addition, as short term interest rates increase, this will push up investment income earned on the cash we would use to repay the loan and the premium.

When the long term interest rates rise (expected to be slower than short term) this will reduce the differential between the rate we borrowed at and the current rate and will result in a smaller premium. Every 0.25% increase would save us £300k on the premium or every 1% rise would save us £1.2m of the redemption premium.

Ideally, we need to redeem at the peak of interest rate cycle, which is not now, but could be expected within 5 years.

To repay the loan today, will cost us £8.8m (£5m principal + £3.8m premium)

This will;

1) Deplete our interest earning capacity.
   With current rates we would expect to achieve 0.5% on £8.8m or £44k a year, when the short term interest rate rise this income will increase. If the rate achievable is 1% this will be £88k lost in that year.
2) The premium paid at £3.8m would need to spread over life of loan for accounting purposes resulting in a charge of £136k per annum to revenue.
3) Remove the need for the yearly loan repayment of £377k.
   So in the first year we would make a net saving of:

£136k charge to revenue
£ 44k interest lost
(£377k) yearly loan repayment
£197k in that year

If we assume the short term interest rate rises in 2015/16 the net saving would reduce to:

£136k charge to revenue
£ 88k interest lost
(£377k) yearly loan repayment
£153k in that year

So if we went forward say 5 years and ASSSUMED short term interest rates had moved to 2.5% and long term interest rates moved by 1% (so the assumed proxy discount would be: 7.55%-(3.33+1)% = 3.22%

The table below shows that as short term interest rate increases it will cost us more to repay early and as long term interest rate increases it will cost us less to repay the premium.

Table 1 - Repay loan now with premium of £3.8m

year	Financial year	average short term int rate	investment income lost on £8.8m	total charged to revenue *	estimated cost years 1 -5	current revenue budget	estimated saving years 1-5
1	2014/15	0.5	44,000	135,714	179,714	377,000	- 197,286
2	2015/16	1	88,000	135,714	223,714	377,000	- 153,286
3	2016/17	1.5	132,000	135,714	267,714	377,000	- 109,286
4	2017/18	2	176,000	135,714	311,714	377,000	- 65,286
5	2018/19	2.5	220,000	135,714	355,714	377,000	- 21,286
Totals			660,000	678,571	**1,338,571**	1,885,000	- 546,429
6	2019/20	3	264,000	135,714	399,714	377,000	22,714
7	2020/21	3	264,000	135,714	399,714	377,000	22,714
8	2021/22	3	264,000	135,714	399,714	377,000	22,714
			792,000	407,143	1,199,143	1,131,000	68,143
estimated totals years 1-8			**1,452,000**	**1,085,714**	**2,537,714**	**3,016,000**	**- 478,286**

*- premium of £3.8/28 years

Table 2 - Repay loan in 5 years with premium of £2.6m

year	Financial year	average short term int rate	investment income earned £8.8m	total charged to revenue	estimated cost years 1 -5	current revenue budget	estimated saving years 1-5
1	2014/15	0.5	44,000	377,000	333,000	377,000	- 44,000
2	2015/16	1	88,000	377,000	289,000	377,000	- 88,000
3	2016/17	1.5	132,000	377,000	245,000	377,000	- 132,000
4	2017/18	2	176,000	377,000	201,000	377,000	- 176,000
5	2018/19	2.5	220,000	377,000	157,000	377,000	- 220,000
Totals			660,000	1,885,000	**1,225,000**	**1,885,000**	- 660,000
repay loan with 3.22% proxy			investment income LOST on £7.6m	total charged to revenue **	estimated costs years 6-8	current revenue budget	estimated saving years 6-8
6	2019/20	3	228,000	113,985	341,985	377,000	- 35,015
7	2020/21	3	228,000	113,985	341,985	377,000	- 35,015
8	2021/22	3	228,000	113,985	341,985	377,000	- 35,015
			684,000	341,955	1,025,955	1,131,000	- 105,045
estimated totals years 1-8			**1,344,000**	**2,226,955**	**2,250,955**	**3,016,000**	**- 765,045**

**- £5m loan x (7.55%-4.33%) = £161k a year x (27.81 years less 5 = 22.81 years) = £3.672m then discount this down to £2.6m – note this may be reduced further as have assumed a 1% increase which will save £1.2m on premium but have not taken account of discounted 5 years less. This is charged to revenue over the remaining period of the loan.

The conclusion being that repaying the loan would save money for a few years but then would become more costly overall, to delay repaying now with a view to repaying when the interest rate rises will not reduce costs in the next few years but will save the authority the most overall.

The worst case scenario for Copeland is that interest rates don't rise and that we therefore don't repay now and make savings immediately, however our adviser and economists are forecasting that rates will rise as the economy recovers.